# Draig Resources Ltd.

1996 Annual Report

## Corporate Profile

Draig Resources Ltd. is a Canadian junior oil and gas company engaged in the acquisition, development and production of oil and natural gas reserves in Western Canada. The Company is listed on the Alberta Stock Exchange and trades under the symbol "DRG".

## Annual Meeting

The Annual General Meeting of Draig Resources Ltd. will be held on Thursday, May 29, 1997 at 9:30 a.m. at the 400 Club at 710 - 4th Ave. SW, Calgary, Alberta.

## Contents



## Abbreviations

| | |
|---|---|
| Boe | barrels of oil equivalent |
| Mcf | thousand cubic feet |
| Mcf/d | thousand cubic feet per day |
| Bbls | barrels |
| Bpd | barrels per day |
| Bopd | barrels of oil per day |

# Highlights

| FINANCIAL ($) | | | |
|---|---|---|---|
| Year ended November 30 | 1996 | 1995 | % change |
| Revenue after royalties | $ 1,508,508 | $ 1,588,628 | (5) |
| Funds generated from operations | $ 403,911 | $ 308,383 | 31 |
| Funds generated from operations per share | $ 0.04 | $ 0.03 | 33 |
| Net earnings (loss) | $ 152,372 | $ (213,243) | 171 |
| Net earnings (loss) per share | $ 0.02 | $ (0.02) | 200 |
| Long-term debt | $ 935,000 | $ 1,955,000 | (52) |
| Weighted average number of shares outstanding | 9,231,994 | 9,381,767 | (2) |
| Capital expenditures | $ 622,373 | $ 1,677,465 | (63) |
| **OPERATIONS** | | | |
| Production | | | |
| Natural gas - Mcf | 528,085 | 702,342 | (25) |
| Mcf/d | 1,443 | 1,924 | (25) |
| Average price/Mcf | $ 1.76 | 1.56 | 13 |
| Oil & NGL- Bbls | 28,734 | 38,079 | (25) |
| Bpd | 79 | 104 | (24) |
| Average price/Bbl-oil | $ 26.87 | $ 22.57 | 19 |
| Average price/Bbl-NGL | $ 22.26 | $ 16.09 | 38 |
| Net reserves before royalties (proven & probable*) | | | |
| Natural gas-Mcf | 6,705,000 | 7,915,255 | (15) |
| Oil & NGL-Bbls | 799,300 | 823,656 | (3) |
| * probable risked at 50% | | | |
| Land (acres) | | | |
| Gross | 31,680 | 38,800 | (18) |
| Net | 9,397 | 9,155 | 3 |
| Producing wells | | | |
| Gross | 19 | 22 | (14) |
| Net | 6.5 | 7.9 | (18) |

# President's Message to the Shareholders

This past year saw Draig Resources Ltd. concentrate its efforts on adding new reserves, turning probable reserves into proven producing reserves and improving our financial position. Revenues were virtually unchanged and expenses were reduced considerably resulting in a significant turnaround and improvement in net earnings.

**Highlights** Revenue in 1996 amounted to $1,508,508 compared to $1,588,628 (down 5%) in 1995. • Expenses decreased by 17% to $1,491,762 in 1996.• Net earnings were $152,372, compared to a loss of $213,243 last year, an improvement of $365,615. • Cash flow increased by 31% to $403,911 or $0.04 per share. • Debt was reduced by $1,353,036 and now stands at $1,186,602.

**Financial** During 1996, revenue remained relatively constant at $1,508,508. Funds generated from operations during this period increased by $95,528 to $403,911 and the Company experienced a profit of $152,372 compared to a loss of $213,243 last year.

Revenues remained constant as a result of higher commodity prices. The average sales price for oil was $26.87/bbl, up $4.30 from 1995. The average sales price for natural gas liquids rose $6.17 to $22.26/bbl and the average natural gas sales price in 1996 was $1.76/mcf, up $0.20/mcf. The higher prices have continued into the first quarter of 1997.

Expenses were reduced in 1996 by $310,109. Lower operating costs, depletion and depreciation charges and interest costs all contributed towards an improvement in net earnings. In the spring of 1996, the Company sold off its Ferrier property for a sum of $1,600,000. This provided the Company with the funds to pay down its bank debt and allowed Draig to post a gain of $170,626 on the sale of this property. This also had a positive impact on net earnings.

**Production** In 1996, natural gas production declined by 481 mcf/d to average 1,443 mcf/d, while crude oil and natural gas liquids production declined by 25 bpd to average 79 bpd. Draig's combined production rate for the period was an average of 223 bpd.

**Operations** Activity in 1996 was concentrated in the Giroux area of Northern Alberta. Operational highlights in 1996 were centred around the discovery of a new oil pool in the Giroux area of Northern Alberta. Draig developed this prospect, secured the land and promoted the partners through the initial drilling program. During the second half of 1996, Draig participated in the drilling of three wells in this area resulting in two oil wells and one abandoned well. A central battery is currently being constructed at Giroux. This will lead to lower operating costs. Plans include unitizing this property, and placing the pool under waterflood.

One mile to the west of this pool the Company placed the Viking D pool under waterflood in November. Production should increase in the near future from this pool. In December a compressor was installed at Whitecourt boosting the production from this property by 250 mcf/d.

During the first quarter of 1997 the Company drilled two additional oil wells at Giroux, recompleted a gas well at Tony Creek, recompleted an oil well at Nipisi and is currently constructing the battery at Giroux. This activity will lead to higher production levels in 1997. Draig has finalized an agreement to drill a horizontal well on its Chigwell property and is waiting for a rig to become available before proceeding.

**Reserves** The annual independent evaluation of the Company's proven and probable oil and gas reserves as of December 1, 1996 shows that oil reserves declined by 3% to 799,300 bbl. Natural gas reserves declined by

15% to 6.7 bcf, reflecting the sale of the Ferrier property and the Company's focus on discovering new oil reserves. The net present value of Draig's proven plus risked probable reserves (using escalated prices and discounted at 15%) is $11.7 million, an increase of 9%. Over the course of the year 130,252 bbls of new reserves were added at a finding and on-stream cost of $4.78/boe. At Ferrier, we sold 258,000 boe for $1,600,000 or $6.20/boe. Draig purchased this property in 1995 for $420,000. At November 30, 1996 the Company had an interest in 11 (4.8 net) producing wells and in 31,680 (net 9,397) acres of land.

**MARKETING** The majority of Draig's gas production is sold through long term contracts to Progas Limited and Trans Canada Pipelines which helped to offset the low spot market price for natural gas. During 1996, 98% of Draig's gas production was sold under these contracts at an average price of $1.77/mcf. The remainder was sold into the Alberta spot market, which averaged $1.76/mcf.

The Company's oil and NGLs are marketed through Gibson Petroleum Company Limited and EOTT Energy Canada Ltd. which provide Draig with ready markets and excellent prices. For the first quarter of 1997, the Company fixed 50% of its oil production at a price of $33.04/bbl.

**OUTLOOK** Nineteen ninety-six proved to be another challenging period for Draig Resources Ltd., but we managed a significant turnaround in the financial position of the Company and I believe that Draig is poised for growth in 1997 and beyond.

In March of 1996 the bank imposed a repayment schedule on our line of credit. As a consequence we sold our interest in the Ferrier property and reduced the debt level. The sale of this property was a hidden blessing because it enabled the Company to reduce interest costs while providing us with the necessary funds to develop and exploit our new Giroux discovery. When we sold Ferrier, there were two wells producing from the reservoir. Competitors in the area have now drilled four additional wells into this pool. The old Draig wells will now only capture 2/6 of the remaining reserves. We sold that property at the height of its potential value.

Now for the exciting news. Draig has entered into an agreement to issue a private placement of shares to a local oil and gas company, Macon Resources Ltd. Macon is headed by Keith Conrad, the former president and CEO of Serenpet Inc. and International Colin Energy Corporation. Macon is looking to invest in companies which have significant growth potential. In discussions with Keith and his group at Macon, we have developed a strategic plan for the next five years which will see Draig convert its probable reserves into proven producing reserves and to aggressively increase the production and financial position of the company over that period. We have a production target of 1,000 bpd by year end 1998.

As a result of our arrangement with Macon, I am pleased to announce that Keith Conrad, Chairman of Macon and Christina Fehr, President of Macon, have agreed to stand for election to the Board of Directors of Draig. The two will provide Draig with the financial expertise and the guidance that we will need over the next five years.

The private placement will require shareholder approval and I encourage all shareholders to return their proxies and vote in favour of the private placement.

I expect good things to happen in the foreseeable future.

Respectfully submitted on behalf of the Board of Directors,

Leslie W. Treitz
President and Chief Executive Officer

April 16, 1997

# Operations Review

Activity in 1996 was concentrated in the Giroux area of Alberta. During the year Draig initiated activity on an exploration play which resulted in the discovery of a new oil pool. During 1996 Draig participated in three wells (0.35 net) on this project, resulting in two new oil wells (0.25 net). Subsequent to year end, an additional two new oil wells have been drilled (0.25 net).

Also in the Giroux area, Draig farmed-out its interest in the Giroux Lake Viking "D" oil pool to a company in return for installation of waterflood facilities. Waterflooding the pool has the potential to increase pool productivity by 400%.

Draig will receive a royalty during payout of the waterflood capital; subsequent to payout Draig will retain a 43.5% interest in the project.

**Acquisitions/Divestitures** In 1996 Draig sold its interest in the Ferrier Elkton "A" gas pool for $1,600,000. After deducting net operating revenue from capital expenditures, the sale results in a profit of $1,331,198.

In addition, Draig acquired additional interests at Giroux, Nipisi and Chigwell from partners, and sold its interest in two small, non-operated properties.

**Capital Expenditures** The Company participated in the drilling, completion and tie-in of 5 wells (0.6 net) in 1996. Finding and on-stream costs were $4.78/boe for proved and probable (risked at 50%).

| | 1996 | 1995 |
|---|---|---|
| | $ | $ |
| Drilling and completions | **461,978** | 947,813 |
| Re-completions and workovers | **3,300** | 11,487 |
| Equipping and facilities | **12,326** | 524,424 |
| Geological and geophysical | **16,247** | 70,473 |
| Acquisition of land | **128,522** | 118,227 |
| Miscellaneous | **–** | 5,041 |
| | **$ 622,373** | $ 1,677,465 |
| Disposals | **$ (1,672,792)** | $ (289,238) |
| Total Net Expenditures | **$ (1,050,419)** | $ 1,388,227 |

**Production** Natural gas production during 1996 averaged 1,443 mcf/d, compared to 1,924 mcf/d in 1995, a decrease of 25%. Gas production at the November 30, 1996 year-end was 1,122 mcf/d.

The Company experienced lower production volumes as a result of having divested of its Ferrier property in March.

Oil and natural gas liquids production averaged 79 bpd, a decrease of 24% from the previous year. At fiscal year end, oil and NGL production was 110 bpd.

**RESERVES** Draig's proven reserves of oil (& NGL) and natural gas declined from year end 1995 levels, mainly due to the sale of the Ferrier property, also through oil and gas production. Proven reserve additions at Chigwell, Giroux and Nipisi, Alberta have lessened the impact of the decline.

The 1996 reserves were independently evaluated as at November 30, 1996 by Status Engineering Associates Ltd. and are summarized in the table below.

**MARKETING** Draig's primary natural gas production is sold through long-term gas contracts with Progas Limited and Trans Canada Pipelines Limited. During 1996, 98% of Draig's natural gas production was sold under these contracts, while the remainder came from non-operated properties.

The average price received for natural gas in 1996 was $1.76/mcf, up 13% from 1995.

Draig's oil and NGLs continues to be marketed through such aggregators as Gibson Petroleum Company Limited and EOTT Energy Canada Ltd. and Northridge Petroleum Marketing Inc. The average price received for the year was $26.87/bbl of crude oil and $22.26/bbl for NGLs.

**Reserves**

| | Oil & NGLs (barrels) | | | Gas (millions of cubic feet) | | |
|---|---|---|---|---|---|---|
| | Proven | Probable | Total | Proven | Probable | Total |
| At November 30, 1995 | 448,656 | 375,000 | 823,656 | 6,800 | 1,115 | 7,915 |
| Additions | 74,752 | 19,600 | 94,352 | 243 | 116 | 359 |
| Dispositons | (89,974) | 0 | (89,974) | (1041) | 0 | (1041) |
| Production | (28,734) | 0 | (28,734) | (528) | 0 | (528) |
| At November 30, 1996 | 404,700 | 394,600 | 799,300 | 5,474 | 1,231 | 6,705 |

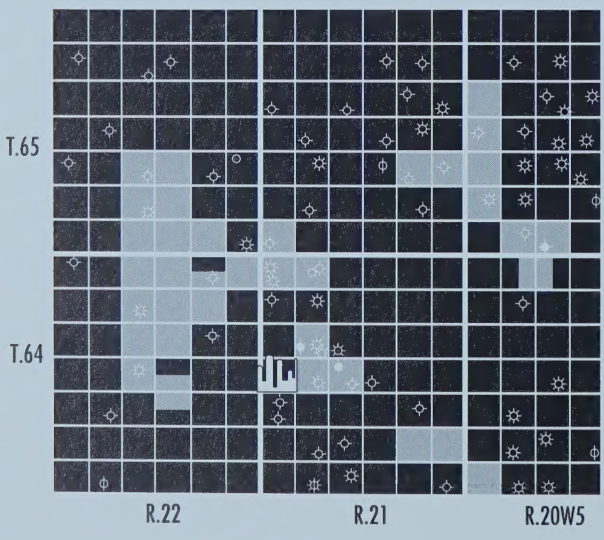
## Tony Creek, Alberta

Gas plant ownership (Draig net 18%) has proved to be very advantageous, with throughput at almost 10mmcf/d. The plant capacity is 12mmcf/d, with expansion possible when full capacity is reached. Draig receives its proportional share of the processing revenue, and 1996 saw a significant increase in this benefit.

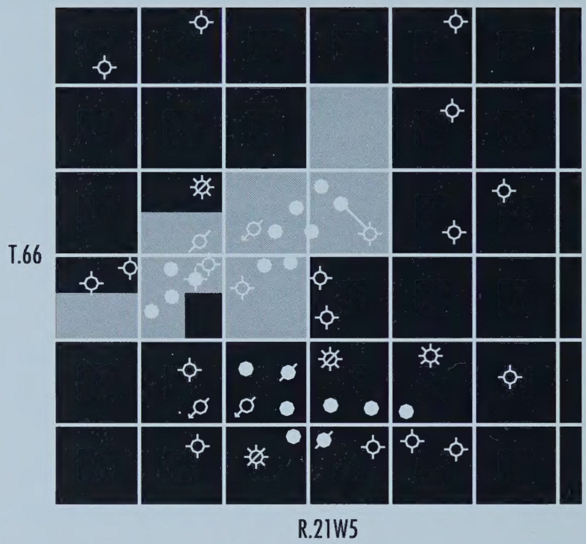
During 1996, Draig's overall net acreage increased in this area. On an asset exchange basis, one producing well and two sections of land (Draig net 2%) were traded for an interest in a producing well at Giroux. Two sections were purchased at a Crown land sale to furnish the development of a new gas prospect.

A successful re-completion was performed on 10-19-63-20 W5M, which added 260 mcf/d to the Company. Production from Tony Creek currently stands at 800 mcf/d net.

Tony Creek




Giroux




## Giroux, Alberta

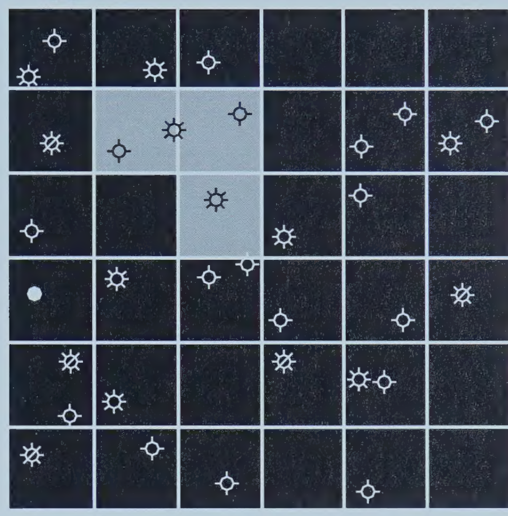
During 1996, a very successful internally generated prospect was developed at Giroux. Draig negotiated to be carried through the initial exploratory well, and now has an interest in four producing oil wells (net 10 - 15%). A battery facility has been constructed and a waterflood program is scheduled to commence May/June 1997. Potential recoverable reserves of this reservoir are estimated at 1 million barrels (Draig net 6% after pooling).

On the adjacent Viking D Pool, a waterflood program is currently underway. A third party completed the installation of the facilities in December 1996, and the positive impact of the development should be realized within six to twelve months.

## Chigwell, Alberta

The Company's two Leduc oil wells are temporarily shut-in due to the area's sour gas flaring limit. However, the situation will soon be rectified. A third party has been secured to drill a development horizontal well to significantly increase the overall production from the reservoir. Once the horizontal well has been completed, the third party will also provide the capital necessary for on-site facilities and pipeline to tie-in to a nearby processing facility. A successful horizontal well also provides the opportunity for an additional horizontal well within the same pool, and the likelihood of several identified exploration leads being pursued. Draig's interest in the area was increased prior to farm-out by the purchase of a partner's interest.

Dapp



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Chigwell

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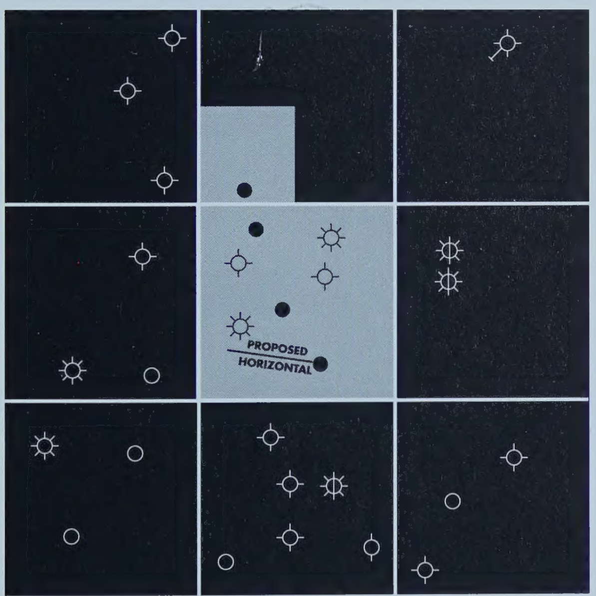


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## Dapp, Alberta

The foundation for this productive area was the purchase of two gas wells and three sections of land (Draig net 25%).

Initial production was 115 mcf/d net, but relatively minor plant improvements boosted the rate to 225 mcf/d net. A development location (Draig net 25%) is proposed for 1997.

# Management's Discussion and Analysis

This management's discussion and analysis of the financial condition and results of operations of Draig for the years ended November 30, 1996 and November 30, 1995 should be read in conjunction with the financial statements contained in this annual report.

**Overview** In 1996 Draig had a conservative capital expenditure program of $622,373, a decrease of 63 % from 1995, partially offset by sales of non-core properties of $1,672,792. The capital expenditure and divestiture program resulted in reduced proved and probable (risked at 50 %) reserves of 63,822 barrels of oil equivalent (boe); results from operations have not achieved the desired results due to significant reserves not yet on production.

**Financial** For the year ended November 30, 1996 funds generated from operations amounted to $403,911 or $0.04 per common share, up from $308,383 or $0.03 per common share in 1995; and net earnings increased to $152,372 or $0.02 per common share.

Oil and gas revenues before royalties declined by 10 % to $1,731,644 compared to $1,930,428 in 1995. The decreased revenue is attributable to lower production volumes of 81,543 boe (223 boe per day) in 1996, compared to 108,313 boe (297 boe per day) in 1995 partially offset by higher average gas prices of $1.76/mcf in 1996 compared to $1.56/mcf in 1995. The Company produced lower production volumes as a result of having divested of its Ferrier property in March, 1996. At November 30, 1996 the Company's gross revenue was derived 42% from oil and liquids, up from 39% in 1995, 54% from gas and 4% from gas processing.

Royalties, net of ARTC, for 1996 amounted to $195,138 or 11% of gross oil and gas sales, compared to $299,642 or 16% of gross oil and gas revenue in 1995. The decrease in net royalties resulted from the government setting lower gas crown royalty rates due to lower gas prices.

The Company continued to have high operating costs on its oil properties especially in the first half of 1996.

General and administrative expenses increased from $321,761 in 1995 to $344,139 in 1996. The general and administrative expenses per boe have increased from $2.97 in 1995 to $4.22 in 1996. Projected production growth without corresponding increases in general and administrative costs should result in declines in general and administrative expenses on a boe basis.

| Netbacks from operations (per boe) | 1996 | 1995 |
|---|---|---|
| | $ | $ |
| Petroleum and natural gas sales | **20.32** | 17.14 |
| Royalties, net of ARTC | **(2.39)** | (2.77) |
| Operating expense | **(7.60)** | (7.29) |
| General and administrative | **(4.22)** | (2.97) |
| Interest | **(1.33)** | (1.27) |
| Dividends | **(0.40)** | (0.30) |
| Other | **0.57** | 0.30 |
| | **$ 4.95** | $ 2.84 |

At November 30, 1996 Draig had tax pools aggregating $3,100,000 which are available for deduction for income tax purposes in future years. Of this amount, $1,500,000 is eligible for deduction in 1997 and the Company does not expect to pay either federal or provincial taxes in 1997. Based upon projected production growth and product prices, the Company may become taxable in 1998.

**CAPITAL EXPENDITURES** The Company participated in the drilling, completion and tie-in of five wells (0.6 net) in 1996 resulting in capital expenditures of $622,373. Finding and on-stream costs were $4.78/boe for proved and probable (risked at 50%) compared to $3.98 per boe in 1995.

| | 1996 | 1995 |
|---|---|---|
| | $ | $ |
| Drilling and completions | **461,978** | 947,813 |
| Re-completions and workovers | **3,300** | 11,487 |
| Equipping and facilities | **12,326** | 524,424 |
| Geological and geophysical | **16,247** | 70,473 |
| Acquisition of land | **128,522** | 118,227 |
| Miscellaneous | **-** | 5,041 |
| | **$ 622,373** | $ 1,677,465 |
| Disposals | **$(1,672,792)** | $ (289,238) |
| Net expenditures | **$(1,050,419)** | $ 1,388,227 |

**LIQUIDITY AND CAPITAL RESOURCES** Draig financed its operations through a combination of cash flow from operations and its bank line of credit of $1,300,000 of which $935,000 was drawn down at year end. The Company's bank facility undergoes an annual review to determine the borrowing capacity based on current reserves and product prices. The Company will be financing its future capital plans through internally generated cash flow and by allowing external partners to participate in projects at terms beneficial to the Company.

**BUSINESS RISKS AND PROSPECTS** Oil and gas exploration and development involves many risks, some of which may not be overcome by extensive technical experience and knowledge, and careful evaluation. Draig attempts to mitigate these risks by using highly qualified staff and up to date technology. The marketability and price of existing oil and gas production as well as production of reserves which will be discovered or acquired by the Company will be affected by numerous factors beyond Draig's control. These factors include demand for oil and gas, market fluctuations, the Canada/US dollar exchange rate, the proximity and capacity of oil and gas pipelines, location of processing facilities, and government regulations.

**ENVIRONMENTAL RISKS** Draig conducts its business in compliance with all provincial and federal environmental regulations and has implemented and documented a safety manual and an emergency response plan to ensure that prompt action is taken in the event of a field accident. The Company has made a cumulative accounting provision for site restoration of $100,951 using the unit-of-production method based upon estimates from independent engineers.

# Auditors' Report to the Shareholders

We have audited the balance sheets of Draig Resources Ltd. as at November 30, 1996 and 1995 and the statements of operations and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at November 30, 1996 and 1995 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG

Chartered Accountants

Calgary, Canada
January 31, 1997

# Balance Sheets

November 30, 1996 and 1995

| | 1996 | 1995 (note 5) |
|---|---|---|
| **Assets** | | |
| Current asset: | | |
| Accounts receivable | $ 269,697 | $ 277,003 |
| Property, plant and equipment (note 2) | 4,081,673 | 5,317,968 |
| | $ 4,351,370 | $ 5,594,971 |
| **Liabilities and Shareholders' Equity** | | |
| Current liabilities: | | |
| Bank indebtedness (note 3) | $ 63,133 | $ 24,276 |
| Accounts payable | 458,166 | 837,365 |
| | 521,299 | 861,641 |
| Long-term debt (note 4) | 935,000 | 1,955,000 |
| Convertible preferred shares (note 6) | 358,000 | 358,000 |
| Provision for site restoration costs | 100,951 | 70,288 |
| Shareholders' equity: | | |
| Share capital (note 5) | 2,485,840 | 2,552,134 |
| Deficit | (49,720) | (202,092) |
| | 2,436,120 | 2,350,042 |
| | $ 4,351,370 | $ 5,594,971 |

See accompanying notes to financial statements.

On behalf of the Board:

Director

Director

# Statements of Operations and Deficit

Years ended November 30, 1996 and1995

| | 1996 | 1995 (note 5) |
|---|---|---|
| Revenue: | | |
| Oil and gas sales, net of royalties | $ 1,499,626 | $ 1,562,757 |
| Gas processing, net of expenses | 8,882 | 25,871 |
| | 1,508,508 | 1,588,628 |
| Expenses: | | |
| Operating | 619,661 | 789,103 |
| Depletion and depreciation | 387,165 | 521,626 |
| General and administrative | 344,139 | 321,761 |
| Interest | 108,577 | 137,161 |
| Dividends - convertible preferred shares | 32,220 | 32,220 |
| | 1,491,762 | 1,801,871 |
| Income (loss) before other item | 16,746 | (213,243) |
| Gain on sale of oil and gas properties | 170,626 | – |
| Earnings (loss) before income taxes | 187,372 | (213,243) |
| Income taxes - deferred | 35,000 | – |
| Net earnings (loss) | 152,372 | (213,243) |
| Deficit, beginning of year | (202,092) | 11,151 |
| Deficit, end of year | $ (49,720) | $ (202,092) |
| Earnings (loss) per common share | $ 0.02 | $ (0.02) |

See accompanying notes to financial statements.

# Statements of Changes in Financial Position

Years ended November 30, 1996 and1995

| | 1996 | 1995 |
|---|---|---|
| Cash provided by (used in): | | (note 5) |
| Operations: | | |
| Net earnings (loss) | $ 152,372 | $ (213,243) |
| Items not affecting cash: | | |
| Depletion and depreciation | 387,165 | 521,626 |
| Deferred income taxes | 35,000 | – |
| Gain on sale of oil and gas properties | (170,626) | – |
| Funds generated from operations | 403,911 | 308,383 |
| Change in non-cash working capital | (371,893) | 111,754 |
| | 32,018 | 420,137 |
| Financing: | | |
| Long-term debt | (1,020,000) | 1,000,000 |
| Common shares repurchased | (101,294) | – |
| | (1,121,294) | 1,000,000 |
| Investments: | | |
| Proceeds on sale of oil and gas properties | 1,672,792 | 289,238 |
| Property, plant and equipment additions | (622,373) | (1,677,465) |
| | 1,050,419 | (1,388,227) |
| Increase (decrease) in cash | (38,857) | 31,910 |
| Cash, beginning of year | (24,276) | (56,186) |
| Cash, end of year | $ (63,133) | $ (24,276) |
| Funds generated from operations per share | $ 0.04 | $ 0.03 |

Cash consists of cash and bank indebtedness.

See accompanying notes to financial statements.

# NOTES TO FINANCIAL STATEMENTS

Years ended November 30, 1996 and 1995

Draig Resources Ltd. is engaged in oil and gas exploration, development and production and its shares are listed on the Alberta Stock Exchange.

## 1. Significant accounting policies:

(a) Oil and gas operations:

The Company follows the full cost method of accounting, whereby all costs associated with the exploration for and development of oil and gas reserves are capitalized. Such costs include land acquisitions, geological and geophysical costs, carrying charges for non-producing properties, costs of drilling both productive and non-productive wells, production and gathering equipment, and administrative costs directly associated with these activities. Gains or losses are recognized upon disposition of oil and gas properties when crediting the proceeds against accumulated costs results in a material change in the rate of depletion.

The capitalized costs together with estimated future capital costs associated with development of proven reserves are depleted and depreciated using the unit-of-production method which is based on proven oil and gas reserves before royalties as determined by the Company and independent engineers. The cost of significant unevaluated properties is excluded from the depreciation and depletion base. For purposes of the depletion and depreciation calculations, oil and gas reserves are converted to a common unit of measure based upon their relative energy content.

The capitalized costs less accumulated depletion and depreciation are limited to an amount equal to the estimated future net revenue from proven reserves (based on prices and costs at the balance sheet date) less estimated future general and administrative expenses, financing costs, income taxes and estimated future abandonment and site restoration costs.

(b) Site restoration costs:

Estimated future removal and site restoration costs are provided for over the life of the proven reserves before royalties on a unit-of-production basis. Costs are estimated each year by the Company and independent engineers based upon a review of current regulations, costs, technology and industry standards. The annual charge is included in depletion and depreciation expense and actual removal and site restoration expenditures are charged to the accumulated provision account as incurred.

(c) Joint activities:

Substantially all of the exploration and production activities of the Company are conducted jointly with others and accordingly these financial statements reflect only the Company's proportionate interest in such activities.

(d) Depreciation:

Gas plant and equipment are recorded at cost and are depreciated over the useful life of the assets.

(e) Per share data:

Per share amounts are calculated based on the weighted average number of shares outstanding during the year. Fully diluted per share amounts are not disclosed as the effect of the exercise of the options, warrants and the conversion of preferred shares would not be materially dilutive.

(f) Financial instruments

*(i)* In order to protect the Company from downward commodity price fluctuations, the Company enters into forward sales arrangements which provide a known, contractual price for designated future production.

*(ii)* The carrying amounts of cash, accounts receivable and accounts payable approximate their fair value. Long term debt is at a variable interest rate and is assumed to be at fair value.

## 2. Property, plant and equipment:

| November 30, 1996 | | Cost | | Accumulated depletion and depreciation | | Net book value |
|---|---|---|---|---|---|---|
| Oil and gas properties and well equipment | $ | 5,191,641 | $ | 1,220,431 | $ | 3,971,210 |
| Gas plant and equipment | | 146,068 | | 35,905 | | 110,163 |
| | $ | 5,337,709 | $ | 1,256,336 | $ | 4,081,373 |
| November 30, 1995 | | | | | | |
| Oil and gas properties and well equipment | $ | 6,084,083 | $ | 874,068 | $ | 5,210,015 |
| Gas plant and equipment | | 133,742 | | 25,789 | | 107,953 |
| | $ | 6,217,825 | $ | 899,857 | $ | 5,317,968 |

Oil and gas properties with a net book value of $775,302 (1995 - $842,353) have no cost base for income tax purposes. This results from the renunciation of income tax deductions to flow-through share investors. As at November 30, 1996, petroleum and natural gas property costs include $404,406 (1995 - $557,412) related to undeveloped properties which are excluded from depletion calculation.

During the year, the Company capitalized $115,535 (1995 - $119,564) of administrative costs pertaining to the Company's exploration, development and property acquisition activities.

## 3. Bank indebtedness:

Bank indebtedness consists of cheques issued in excess of cash in bank.

## 4. Long-term debt:

The Company has a demand credit facility of $1,300,000 with a Canadian chartered bank. It is secured by a $5,000,000 floating charge debenture, a $5,000,000 first fixed charge debenture and a general security agreement. Loans under this facility bear interest at the bank's prime rate plus 3/4%. Although loans under this facility are due on demand, no principal repayments are required in the next year providing the Company satisfies the bank's requirements under the loan agreement.

## 5. Convertible preferred shares:

(a) The Company has retroactively adopted the recommendations of the Canadian Institute of Chartered Accountants relating to the presentation and disclosure of financial instruments. The new recommendations have been applied retroactively in these financial statements. In accordance with these recommendations, the convertible preferred shares are presented as long-term debt. Net loss for the year ended November 30, 1996 and 1995 has been increased by $32,220 to reflect the deduction of preferred dividends paid during the period.

(b) Issued and outstanding:

One series of First Preferred Shares has been issued being the First Preferred Shares Series A which bear a 9% cumulative dividend, payable quarterly. These shares are non-voting and are convertible at the option of the holder into common shares on the basis of one common share for one preferred share; and at the option of the Company if the most recent five-day weighted average trading price of the common shares exceeds $1.75 per common share on the same basis. At November 30, 1996 and 1995 447,500 First Preferred Shares are outstanding at $358,000.

## 6. Share capital:

(a) Authorized:

Unlimited number of common voting shares without nominal or par value.

Unlimited number of First Preferred Shares issuable in series. With respect to payment of dividends and distribution of assets in the event of dissolution winding up or liquidation of the Company these shares shall be entitled to preference over the common shares and the shares of any other class ranking junior to the First Preferred Shares.

Unlimited number of Second Preferred Shares issuable in series. With respect to the payment of dividends and distribution of assets in the event of dissolution, winding up or liquidation of the corporation these shares shall rank subordinate to the First Preferred Shares and shall be entitled to preference over the common shares.

(b) Issued and outstanding

| | Common Shares | |
|---|---|---|
| | Number | Amount |
| November 30, 1995 and 1994 | 9,381,767 | $ 2,552,134 |
| Repurchase of common stock | (384,000) | (101,294) |
| Deferred tax effect of share issuance costs | - | 35,000 |
| November 30, 1996 | 8,997,767 | $ 2,485,840 |

There are no Second Preferred Shares issued.

(c) Stock options:

The Company has established a stock option plan whereby officers, directors, employees and consultants may be granted options to purchase common shares up to ten percent of the issued and outstanding common shares. As at November 30, 1996, the Company had 657,500 options outstanding exercisable at prices ranging from $0.10 to $0.27 expiring from June 30, 1997 to January 24, 1998. All of the 257,500 options having an exercise price of $0.10 per share were exercised on January 6, 1997.

## 7. Income taxes:

The provision for income taxes differs from the result which would have been obtained by applying the combined federal and provincial income tax rates to the Company's income or losses before income taxes. The difference results from the following:

| | 1996 | 1995 |
|---|---|---|
| Earnings (loss) before income taxes | $ 187,372 | $ (213,243) |
| Statutory income tax rate | 44.6% | 44.3% |
| Expected income taxes (recovery) | $ 83,568 | $ (93,850) |
| Non-deductible Crown payments, net | 47,992 | 72,329 |
| Depletion related to property with no tax base | 29,905 | 35,585 |
| Non-deductible dividends | 14,300 | 14,200 |
| Other | 427 | 576 |
| Unrecognized benefit of losses | – | 50,837 |
| Resource allowance | (76,055) | (79,677) |
| Income tax reduction resulting from the benefit of prior year's losses | (65,137) | – |
| Provision for income taxes | $ 35,000 | $ – |

## 8. Commitment:

The Company is committed to rental lease payments through to 1998. Minimum payments are:

| | |
|---|---|
| 1997 | $ 33,436 |
| 1998 | 6,930 |

The Company recovers a portion of lease payments through other subleases.

# Corporate Information

## Directors

Carole E. Atkinson (1)
Vice President Exploration,
and Corporate Secretary
Draig Resources Ltd.
Calgary, Alberta

Garry Tether (1)
Vice President
Operations & Treasurer
Draig Resources Ltd.
Calgary, Alberta

Leslie W. Treitz
President and
Chief Executive Officer
Draig Resources Ltd.
Calgary, Alberta

Jack Balaban (1)
Corporate Director
Calgary, Alberta

## Officers and Senior Management

Leslie W. Treitz
President and
Chief Executive Officer

Carole Atkinson
Vice President Exploration
and Corporate Secretary

Garry Tether
Vice President
Operations and Treasurer

David Wilson
Controller

(1) Member of Audit Committee

## Head Office

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Telephone (403) 263-3181
Fax (403) 269-5515

## Auditors

KPMG Peat Marwick Thorne
Chartered Accountants
Calgary, Alberta

## Bankers

Royal Bank of Canada
Calgary, Alberta

## Corporate Counsel

Code Hunter Wittmann
Calgary, Alberta

## Registrar & Transfer Agent

Montreal Trust Company
of Canada
Calgary, Alberta

## Stock Exchange Listing

Alberta Stock Exchange
Trading Symbol: DRG

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